CIRCUIT COURT OF HALIFAX COUNTY.

E. M. Birdsall & Co. v. Wm. Guill.

Negotiable Instruments—*Stipulation to pay attorney's fees.* A note, if otherwise in negotiable form, is not affected as an instrument of the law merchant, by a stipulation on the part of the maker to pay ten *per centum* additional, as attorney's fees, in case of non-payment at maturity.

Negotiable Instruments—*Stipulation for retention of title to chattel.* A promissory note, otherwise in negotiable form, is rendered non-negotiable by a stipulation therein on the part of the maker, that "the title, ownership or right of possession" of the chattel which is the consideration of the note "does not pass from the E. M. B. Co. [payee] until this note, with interest, attorney's fees and cost, is paid in full."

Whittle, J:

This is an action of assumpsit brought against the maker, William Guill, and first endorser, J. H. Franklin, upon an instrument which reads as follows:

"$418.00 Franklin Junction, Va., July 9, 1883.

"On the first day of November, 1885, we, or either of us, whose postoffice address is Elba, county of Pittsylvania, and State of Virginia, promise to pay the E. M. Birdsall Company, or order, four hundred and eighteen dollars, for value received, payable at the Planters' National Bank in Danville. Va., with interest from date, at the rate of 6 per cent. per annum, with all costs for collection, including 10 per cent. attorney's fees. This note being given for engine and thresher.

"The express conditions of the sale and purchase of the foregoing described property for which this note is given, are such that the title, ownership, or right of possession does not pass from the E. M. Birdsall Co. until this note, with interest, attorney's fees and costs, is paid in full."

At the last term there was a demurrer to the declaration. Two grounds of demurrer were assigned, both arising out of the form of the instrument sued on; and the contention is that each destroys its character of negotiability.

It is insisted:

1st. That the stipulation for the payment of "all costs for collection including, 10 per cent. attorney's fees," renders the liability of the maker and endorser *uncertain*; and takes the paper out of the definition of a negotiable instrument, which is: a written promise to pay a certain sum of money at a certain time and place, absolutely and at all events. Much can be said in support of this contention; and it is

not clear that the language employed covers only taxable costs. But Mr. Daniel in his work on Negotiable Instruments, sec. 61 and *seq*, is of opinion that the more recent cases sustain the negotiability of instruments containing like provisions.

He lays down the doctrine that while it is essential to the negotiability of a bill or note that it purport to be only for the payment of money, the rule is subject to the qualification that if the superadded agreement does not impair the certainty of the promise to pay the amount named, but only facilitates the means of collection, it does not destroy the negotiability of the instrument; that the later cases maintain the negotiability of a note with a stipulation for the payment of "collection and attorney's fees." And referring to the declaration of Gibson, C. J., in *Overton* v. *Tyler*, 3 Barr, 346, that a negotiable bill or note is "a courier without luggage," he remarks, that "provisions which facilitate rather than encumber the circulation of such instruments are not luggage, but ballast." And Cobbs, J., in delivering the opinion of the court in *Heard* v. *Dubuque Co. Bank*, Supreme Court of Nebraska, *The Reporter*, vol. 6, p. 590–1 (30 Am. Rep. 811), said, of a note with a stipulation in the event of suit brought to enforce collection to pay "reasonable attorney's fees":

"We do not think the amount of money represented by a note or bill is made any the less certain by reason of its containing a stipulation that if it is not paid at maturity, the maker will pay a part of the expenses of collection. Such a stipulation adds to the value of the paper, has a tendency to lower the rate of discount on it, not only because it promises less expensive collection, but bears evidence of a greater degree of confidence on the part of the maker to pay without suit. The stipulation to pay attorney's fees is harmless, to say the least, while the note is undishonored and entitled to pass as commercial paper. It is only when it becomes dishonered by its maker, and ceases to have any standing in the commercial world, that the provision is vivified. Looking to the spirit as well as the letter of a time-honored definition, certainly 'a courier without luggage' is none the less efficient for all purposes by reason of having about him something with which to pay his reckoning. 32 Iowa 184; 38 Md. 323; 23 La. 767; 63 Mo. 33."

I am of opinion that the first point is not well taken.

2d. That the negotiable character of the instrument is destroyed by reason of the stipulation that the payee reserves "the title, ownership or right of possession" of the property, the sale of which constituted *the sole consideration of the note.*

This necessitates an enquiry as to the legal effect of the paper taken as a whole.

Is the sale of the engine and thresher an absolute sale, or a conditional sale, and in whom does the title abide, and at whose risk is the property until paid for? If the sale be conditional, and if the title to the property remains in the vendor, must it not follow that it so remains at his risk, in the absence of an agreement to the contrary? And if this be true, can it be said there is an absolute and unconditional promise to pay for it—a promise to pay at all events? Would not the vendee be exonerated from liability to pay, if the property should perish before the maturity of the note, without his fault—or in the event it should be recovered by a title paramount to that of the vendor—he being notified of action brought and required to defend it? It seems to me these queries admit of only an affirmative response.

"A conditional sale," say Rapalje and Lawrence, in their Law Dictionary, "is a sale which is made on condition, upon the performance of which the passing of the title depends." By the express terms of the clause under consideration, neither title to property nor right of possession were to pass until the purchase price, with attorney's fees and costs, should be paid in full. The vendor in effect says, "I am unwilling to part with my property upon a mere promise to pay; and I shall retain both right of property and right of possession until payment," and in doing this, it would seem, he assumes the risk of all loss and damage which may accrue until the title by the terms of the contract passes from him. If these results flow from the reservation of title, etc., then every endorsee, even for value and before maturity, takes the paper with knowledge that there is not an *absolute* and *unconditional* promise on the part of the maker to pay the debt, but that a state of facts may arise in which he will be absolved from liability; and, therefore, the instrument is not within the definition of negotiable paper.

It is laid down in 1 Benj. on Sales, Amer. notes by Charles L. Corbin, sec. 427, p. 339, etc., that:

"The seller, retaining title, is the owner of the natural increase of the property and may recover it, if the condition is broken. Thus in *Buckmaster* v. *Smith*, 22 Vt. 203, the seller recovered in trover not only for a mare, which he had sold on condition, but also her colt produced while in the possession of the person who had contracted to purchase. On the other hand the risk of loss of the property remains with the owner, in the absence of any agreement to the contrary, though possession and use may be given to the buyer. Thus in *Swallow* v. *Emery*, 111 Mass. 355, horses were sold at a stipulated price, to be kept and used by the buyer but not to be his property until paid for. One of the horses died without fault of the buyer, and it was held that it was the seller's loss, and he could only re-

cover the price of the rest of the property sold, and that he could not reclaim the residue of the property after he had received its fair value. The giving of a note for the whole price was considered by Grover, J., in *Ballard* v. *Burgett*, 40 N. Y. 314, to be evidence that the property was at the risk of the buyer notwithstanding an agreement reserving title. But later cases hold that no recovery can be sustained on such a note, if the consideration fail." (Citing *Loring* v. *Loring*, 64 Me. 556; *Kent* v. *Buck*, 45 Vt. 18.)

The case of *Wright* v. *Traver*, 41 N. W. R. 517, differs from the case at bar in this, that title passed to the vendee, but there was a stipulation that if the note was not paid when due the property for which it was given should be the property of the payee (vendor). "This," says the court, "appears to us to destroy its character as a promissory note, and reduces it to a mere contract." The court takes the view that the maker had an option to pay the amount called for at maturity, or to return the property. And it said further: "The instrument before us has more the appearance of a contract of sale, with the title reserved in the property to the seller until paid for, than it has of a promissory note."

In the case of *Heard* v. *Dubuque Co. Bank*, 8 Neb. 10 (30 Am. Rep. 811, *The Reporter*, vol. 6, pp. 590–1), much relied on by counsel for demurree, the judge in passing upon the negotiability of an instrument, with a condition or reservation identical with the one we are considering, says: "An examination of the note will fail to disclose that the sale of an Ohio mower and reaper, was the sole or any part of the consideration for giving the note." He rests his opinion upon that fact, and it is fair to presume the decision would have been different if the mower and reaper had constituted the consideration of the note and the paper had so shown. The questions submitted are interesting and not free from difficulty, and the authorities on them are divided; but the weight of those to which I have had access, and the best consideration I have been able to give the matter, lead me to the conclusion that the instrument upon which this action is founded is not negotiable. The demurrer will have to be sustained.

NOTE—*Conditional sales—risk of property—negotiable paper.* The distinction between true conditional sales of personal property and stipulations in the nature of conditions amounting in substance to mortgages to secure the purchase price, are extremely close, and, as said by the learned judge in the foregoing opinion, the decisions of the courts are not harmonious on the subject. In a true conditional sale, fulfillment of the condition is generally essential to a complete sale—performance of the vendee's undertaking is a condition precedent to the conversion of the executory contract into an executed sale. Until fulfillment, the con-

tract is a mere agreement to sell and to buy, on the part of vendor and vendee, respectively. Hence, in the latter case, and in the absence of an agreement express or implied to the contrary, the ordinary principle of sales applies, and the property remains at the risk of the seller; and if the property perishes before performance of the condition, the loss falls on the seller, and the buyer is absolved from his undertaking to pay.

In *Burnley* v. *Tufts*, 66 Miss. 48 (14 Am. St. Rep. 540), the plaintiff sold defendant a soda water fountain, and took several notes with an absolute promise of payment, but with a stipulation that "the title to the property does not pass to me, and until all said notes are paid the title to the aforesaid property shall remain in the said James W. Tufts" (seller). Before payment of the note in suit the property was destroyed by fire without vendee's default. It was held that as nothing remained to be done on the part of the seller, and as the buyer had received all that he was to receive as the consideration for his absolute promise to pay, the transaction was an executed sale, and the property perished as the property of the buyer.

Precisely the same contract, in which the same Tufts was plaintiff, came before the Supreme Court of North Carolina, and the Appellate Court of Missouri, and the same defense was made—viz: destruction of the property by fire without vendee's default. It was held in each case that the property was at the buyer's risk. The North Carolina court distinguished *Emery* v. *Swallow*, 111 Mass. 356, because in that case after payment the vendor was to execute a bill of sale. *Tufts* v. *Griffin*, 107 N. C. 47; *Tufts* v. *Wynne*, 45 Mo. App. 42. See also *Humeston* v. *Cherry*, 23 Hun. (N. Y.) 141; *Planters Bank* v. *Van Dyck*, 4 Heisk. (Tenn.) 617.

In Freeman's note to *Tufts* v. *Griffin* (*supra*), 22 Am. St. Rep. 862, 867, it is said: "Under conditional sales where title to the property is to remain in the seller until the purchase price is fully paid, while the possession passes to the purchaser at the time of sale, there seems to be an irreconcilable conflict in the authorities, as to which party should bear the loss in case the property is lost or destroyed without the fault of the seller, before the last payment of the purchase price is made. It seems to us that the better reasoning is in favor of the rule adopted in the case of simple sales, and that the loss should be borne by the purchaser." Authorities cited for this position are the two cases last cited; and as contrary, *Randle* v. *Stone*, 77 Ga. 501 and *Swallow* v. *Emery*, *supra*. The former view is taken in *Choate* v. *Stevens* (Mich.) reported in *Chicago Legal News*, March 1, 1898, p. 236.

Whether the transaction is a conditional sale and therefore executory, or a mortgage, and therefore in substance an executed sale with a re-transfer of title to the seller by way of security, depends upon the intention of the parties, as derived from the terms of the contract. And in construing the contract, the court will look at its substance, rather than its form—and will not consider itself bound by the name which the parties may have seen fit to apply to the transaction.

Thus in *Herryford* v. *Davis*, 102 U. S. 235, the plaintiff sold to a railroad company certain rolling stock, taking its notes, secured by collateral, for deferred payments. The contract was in the form of a lease—and "repeatedly spoke of loaning the cars to the railroad company for hire for four months." No rental price was mentioned, however, and the notes executed represented the full value of the property delivered. It was stipulated that these notes were to be held as

collateral security, collected at maturity, and held "for the safe custody and return to the party of the first part, when demanded, of said cars, etc., delivered for hire," with the right on the part of the railroad company "to purchase (the cars) at any time within the said period of four months," upon payment of the notes; and until such payment the railroad company was to have no right, title or interest in the property, except the use thereof during the four months.

The court held that the terms of this transaction were wholly inconsistent with any idea of a lease—and while a lease in form, it was in fact an executed sale, with a hypothecation of the property by the buyer with the seller to secure the purchase price; and that not being registered, it was void as to other creditors of the railroad company.

The question came again before the same court in *Harkness* v. *Russell*, 118 U. S. 663, where, on a different state of facts, the transaction was held to be a true conditional sale, and not an executed sale, with title hypothecated to seller. Here the seller exacted the condition that "the title, ownership or possession of said engine . . . . does not pass from R. & Co. (sellers) until this note and interest shall have been paid in full." The seller was also authorized whenever he deemed himself insecure, even *before the maturity* of the note, to take possession of the property. If taken back, the property was to be sold or valued, and the proceeds or value credited on the note, and the buyer was to pay any balance due as damages and rental for the property. The buyer afterwards sold the property to a purchaser who had full notice of the condition and its non-fulfillment, and the seller brought an action against the second buyer for its value.

Though not necessary to the decision, since the defendant had notice of the conditions, the court went into a full discussion of the subject, and held that it was clearly the intention of the parties to enter into an executory contract of sale only, and distinguished and approved the ruling in *Herryford* v. *Davis*, *supra*.

In neither of these cases was there any question as to the negotiability of the evidences of debt, or as to who should bear the loss in case the property perished before the fulfillment of the condition.

The subject was again before the court in the case of *Chicago etc. Co.* v. *Merchants' National Bank*, 136 U. S. 268. The suit here was by the indorsee against the maker of one of a series of notes representing the purchase price of certain railroad cars, title to which was expressly retained in the note, until payment. The note contained the statement that it was given "for the purchase price" of the property, and stipulated that "the title to said cars shall remain in the said payee (seller) until all the notes of said series, both principal and interest, are fully paid, all of the said notes being equally and ratably *secured on said cars*."

This transaction the court held to be an executed sale, and the stipulation quoted merely a short form of chattel mortgage. Special emphasis was laid upon the use of the words "purchase price" of cars "sold" by the payee, and "secured" on the cars. And this being true, the transaction was held to be an executed sale, and the note to be an instrument of the law merchant, not affected by any equities in favor of the maker against the payee, of which the holder had no notice.

Assuming that the negotiability of the note in the principal case depends upon the question whether the transaction was an executed sale, placing the risk of the property upon the buyer, or an executory contract to sell, leaving the property at

the risk of the seller, a comparison of the contract in that case, with those construed in the foregoing cases, would lead us rather to the conclusion that it was a consummated sale. Following the promise to pay in the ordinary form of a negotiable note, is this language: "*For engine and thresher.* The express conditions of the *sale and purchase* of the foregoing described property for which this note is given, are such that the title, ownership or right of possession does not pass from the E. M. B. Co. (seller) until this note with interest, attorney's fees and costs is paid in full." This language rather indicates that there was a "*sale and purchase*" of the property. The note was executed "*for engine and thresher*;" and there seems to be nothing in the contract, as in *Harkness* v. *Russell*, *supra*, to indicate that the contract was executory; but rather that the transaction was, as in the other cases cited, and especially as in *Chicago etc. Co.* v. *Merchants' National Bank*, a short form of chattel mortgage. This conclusion is not free from doubt, however. The case differs from the case last cited, in that on the face of the contract in the principal case the right of *possession* is retained by the seller, while in *Chicago etc. Co.* v. *Merchants' National Bank*, there was no such stipulation—a fact commented upon by the court in that case.

In *Chicago etc. Co.* v. *Merchants' National Bank*, the court expressly declined to decide what would have been the effect had the transaction been regarded as a conditional sale.

But assuming that the transaction in the principal case *was* a true conditional sale, and that the risk of the property *was* in the seller, and that the destruction of the property before maturity *would* have been a good defense as against the seller, do these circumstances render the note non-negotiable?

In every sale of personal property, and in almost every conceivable transaction out of which the execution of negotiable paper arises, there are possible defenses or equities available against the payee in favor of the maker or payer. Every indorsee of negotiable paper knows, in fact or in law, that there *may* be such defenses—that it is *possible* that defenses exist—and, if he has knowledge of the consideration, what those possible defenses are. But unless he knows that they *do in fact* exist, he is not bound by them, nor bound to make inquiry. Nor does the fact that the paper states the consideration on its face, put the indorsee on notice. He is only bound by such defenses as he knows to exist. He is not required to make inquiries which would lead to a knowledge of such defenses.

Suppose, for example, the note in question had merely recited that it was executed for "engine and thresher." In the absence of special circumstances, the vendor, in every such sale, as a matter of law, warrants the title. If the buyer (and maker of the note) loses the property by title paramount, he may set up against the payee (seller) the defense of failure of consideration. Every indorsee would take such paper, charged, as a matter of law, with notice that there was a warranty of title, and, in case of breach, that there would be a failure of consideration and a good defense would result in favor of the maker. Yet, it would not be seriously argued that such a note is not a good negotiable instrument, or that the indorsee who took it in due course, without notice that title had actually failed, would not acquire complete title, free from equities.

Suppose again, the note had contained no reference to the sale and purchase, but that the indorsee, taking the paper in due course, had actual knowledge that it represented the purchase price of an engine and thresher. Here, again, he

would be charged with notice that there was warranty of title, and that there were possible express warranties out of which possible defenses might arise. Yet unless he knew that such equities *in fact* existed, he would hold the paper free from such defenses. Nothing short of bad faith will charge a holder in due course, with notice. *Frank* v. *Lilienfeld*, 33 Gratt. 377, 390. Thus in *Davis* v. *McCready*, 17 N. Y. 230 (72 Am. Dec. 461), cited in the opinion in the principal case, the holder purchased a bill which he knew had been executed in part payment of the price of a ship, which, by the bargain, and *to his knowledge*, was to be put in a seaworthy condition. This bargain had been broken, but of this the holder was ignorant. It was held that he took the bill free from the equity.

In *Cameron* v. *Chappell*, 24 Wend. 94, an acceptance was given in consideration of a promise by the drawer, *known to the indorsee* when he took the bill, to ship to the acceptor a certain amount of wheat, before maturity of the bill, which promise was not kept. Here, of course, the holder knew that if the wheat was not shipped accordingly, there would be a good defense, yet, as the contract had not been broken to his knowledge, it was held that he was a *bona fide* holder and entitled to recover.

In *Taylor* v. *Curry*, 109 Mass. 36, the note contained a memorandum "on policy No. 33,386." The policy contained a stipulation for set-offs against notes due the company. It was held that the note was nevertheless negotiable, and that the holder was not put upon inquiry.

In *Jennings* v. *Todd*, 118 Mo. 296 (40 Am. St. Rep. 373), there was a collateral agreement, executed contemporaneously with the note, providing that the note was not to be paid if the agreement which was the consideration of the note should not be performed; and this agreement was *known to the indorsee* when he took the note—but he had no notice of its breach. He was held entitled to recover as a *bona fide* holder, the court saying, quoting from 1 Parsons on Notes and Bills, p. 261: "Knowledge on the part of the holder at the time he took the note, that it was not to be paid on a specified contingency, is not sufficient to defeat his right to recover, although the contingency had then happened, if he was ignorant of this fact." To the same effect are numerous authorities cited in the opinion (40 Am. St. Rep. at p. 378) and in Editor's note (Id. 381-2).

In 1 Daniel on Neg. Instruments, 797, the doctrine is thus stated: "The mere statement of the consideration in a bill or note does not put the holder upon inquiry *whether or not it really passed* or *has failed in any respect*. It is rather assuring than otherwise, for it is evidence, if the note be genuine, that it is given for value; and the specification of what value can no more challenge the holder's investigation than the omission of such specification. In legal effect it does not qualify the paper in any respect." The author refers to two or three cases to the contrary, with the comment that "this cannot be, and has been held not to be, law. Amongst other cases, he refers to a New York case where the note expressed that it was given for "one knitting machine, warranted," in which it was held that this did not render the note non-negotiable or put the holder on inquiry as to whether the warranty had been broken or not. So with a note expressed to be in consideration of the sale of a patent right. The holder need not inquire whether the defense of invalidity of the patent exists or not. *Borden* v. *Clarke*, 26 Mich. 412. See also *Miller* v. *Ottaway*, 81 Mich. 196 (21 Am. St. Rep. 513). In this case a note had been given as the purchase price of certain mares,

warranted to be with foal. Before maturity it was indorsed for value to the plaintiff who knew of the warranty but did not know of its breach. It was held, upon a full citation of authority, that the plaintiff was entitled to recover as a *bona fide* holder.

Applying these principles to the principal case, and assuming that the contract was a true conditional sale, and that destruction of the property or failure of title would have been a good defense, it would seem that the note would still be negotiable—being payable without condition, and there being nothing to put a holder in due course on inquiry. If there was any condition it was in the nature of a defeasance—the promise being not a contract to pay on condition of the continued existence of the property and validity of the title, but rather to pay at all events (as it does in terms) with a defeasance, implied by law, in the contingency of the loss of the property to the maker by destruction or title paramount. There is an obvious distinction between a condition upon the fulfillment of which the maker promises to pay, and an unconditional promise to pay subject to a defeasance in case of breach of counter stipulations on the part of the payee.

The weight of reason and probably of authority sustains the ruling of the principal case, that a stipulation to pay attorney's fees in case of non-payment at maturity, does not affect the negotiability of the instrument. An excellent discussion of the subject will be found in Judge Taft's opinion in *Farmers Nat. Bank* v. *Sutton Mfg. Co.*, 6 U. S. App. 312, 52 Fed. 191, 3 C. C. A. 1, and in the very full argument of counsel on either side in this case, an outline of which is published in 3 C. C. A. 1.